Report

of the

Examination of

Pella Mutual Insurance Company

Marion, Wisconsin

As of December 31, 2001

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State of Wisconsin / OFFICE OF THE COMMISSIONER OF INSURANCE

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Scott McCallum, *Governor*
Connie L. O'Connell, *Commissioner*

Wisconsin.gov

May 24, 2002

Honorable Connie L. O'Connell
Commissioner of Insurance
State of Wisconsin
121 East Wilson Street
Madison, Wisconsin 53702

Commissioner:

In accordance with your instructions, an examination has been performed as of December 31, 2001, of the affairs and financial condition of

Pella Mutual Insurance Company
Marion, Wisconsin

and the following report thereon is respectfully submitted:

I. INTRODUCTION

The last examination of this company was made in 1997 as of December 31, 1996. The current examination covered the intervening time period ending December 31, 2001, and included a review of such subsequent transactions deemed essential to complete this examination.

The Summary of Examination Results contains elaboration on all areas of the company's operations. Special attention was given to the action taken by the company to satisfy the recommendations and comments made in the previous examination report.

The company was originally organized as a town mutual insurance company on November 30, 1876, under the provisions of the then existing Wisconsin Statutes. The original name of the company was the Pella Farmers' Mutual Insurance Company. Subsequent amendments to the company's articles and bylaws changed the company's name to that presently used.

During the period under examination, there were two amendments to the articles of incorporation and no amendment to the bylaws. The first change to the Articles of Incorporation added the counties of Calumet, Kewaunee, Lincoln, Manitowoc, Waushara, Winnebago and Wood. The second amendment to the Articles of Incorporation was the change in the Company's address. A review of the certificate of authority revealed that the company is currently licensed to write business in the following counties:

> Brown, Calumet, Kewaunee, Langlade, Lincoln, Manitowoc, Marathon, Menominee, Oconto, Outagamie, Portage, Shawano, Waupaca, Waushara, Winnebago, Wood

The company is currently licensed to write property, including windstorm and hail and nonproperty insurance.

A review was made of the policy and application forms currently used by the company. The company issues an approved policy with or without endorsements for terms of one year with premiums payable on the advance premium basis. Policy fees charged to policyholders are retained by the company.

Business of the company is acquired through 8 agents, 3 of whom are directors of the company. Agents are presently compensated for their services as follows:

Type of Policy	**Compensation**	
	New	Renewal
Homeowners, Dwelling Fire, Extended Coverage, Rentals/Tenants	20%	15%
Farmowners, Farm Fire, Extended Coverage, Commercial	18%	13%
Mobile Homes	15%	15%

An employee of the company, who is an adjuster and inspector, adjusts most of the losses. Agents have authority to adjust losses up to $2,500. Losses in excess of this amount are adjusted by the Executive Board and/or Adjusting Committee.

Policyholders may participate in the management and control of the company by attending and voting at all annual or special meetings of the members. No member may vote by proxy. The annual meeting of the company for the election of directors and special meetings of the company are held in accordance with its articles of incorporation.

Board of Directors

The board of directors consists of nine members divided into three classes. One class is elected at each annual meeting for a term of three years. The directors may fill vacancies on the board for the interim to the next annual meeting when a director shall be chosen for the unexpired term.

The current board of directors consists of the following policyholders of the company:

Name	Principal Occupation	Residence	Expiry
*David Prey	Independent Insurance Agent	Clintonville, WI	2002
*David Asenbrenner	Insurance Agent/Manager	Clintonville, WI	2004
Bruce Buettner	Farmer	Shawano, WI	2002
*Dennis Breaker	Farmer/Insurance Agent	Tigerton, WI	2002
Debra Adams	Insurance Representative AAL	Clintonville, WI	2003
Nancy Bennett	Insurance Representative AAL	Shawano, WI	2003
Charles Bartz	Farmer	Shawano, WI	2004
Daniel Sazama	Retired	Shawano, WI	2004
Dennis Zahn	Farming	Shawano, WI	2003

Directors who are also agents are identified with an asterisk.

Members of the board currently receive $40.00 for each meeting attended and 34.5 cents per mile for travel expenses, for attending meetings. Directors who are not officers also receive an additional $500 per year for service on the board.

Officers

Officers are elected by the board of directors from among its members and hold office for one year or until their successors are duly elected and qualified.

Officers serving at the present time are as follows:

Name	Office	Annual Salary
David Prey	President	$ 2,000
Bruce Buettner	Vice-President	1,000
David Asenbrenner	Secretary/Treasurer	41,350

Committees of the Board

The company's bylaws allow for the formation of certain committees by the board of directors.

The committees at the time of the examination are listed below:

Adjusting Committee
David Prey, Chair
Bruce Buettner
David Asenbrenner

Growth of Company

The growth of the company during the past five years as compiled from its filed annual statements was as follows:

Year	Net Premiums Earned	Net Losses and LAE Incurred	Policies In Force	Net Income	Admitted Assets	Policyholders' Surplus
1997	$1,119,394	$829,536	4,935	$38,979	$2,067,274	$1,011,007
1998	916,628	811,448	5,052	(81,271)	1,911,796	971,029
1999	1,000,444	731,860	5,064	26,826	2,097,677	978,861
2000	1,041,130	751,727	5,139	54,524	2,267,436	1,104,020
2001	1,086,780	929,734	5,191	(52,415)	2,109,047	1,026,679

The ratios of premiums written, gross and net, to surplus as regards policyholders during the past five years were as follows:

Year	Gross Premiums Written	Net Premiums Written	Ending Surplus	Writings Ratios	
				Gross	Net
1997	$1,625,592	$1,135,836	$1,011,007	160%	112%
1998	1,714,669	792,179	971,029	177	82
1999	1,861,799	1,084,359	978,861	190	111
2000	1,967,467	1,068,812	1,104,020	178	97
2001	1,971,770	1,055,984	1,026,679	192	103

For the same period, the company's operating ratios were as follows:

Year	Net Losses and LAE Incurred	Other Underwriting Expenses Incurred	Net Earned Premiums	Loss Ratio	Expense Ratio	Composite Ratio
1997	$829,536	$373,620	$1,119,394	74%	33%	107%
1998	811,448	266,710	916,628	89	33	122
1999	731,860	348,830	1,000,444	73	32	105
2000	751,727	324,938	1,041,130	72	31	103
2001	929,734	320,022	1,086,780	86	30	116

The high loss ratios are due to major barn and structural fires and storm damage in the past few years. The company has had 14 consecutive years of underwriting losses, the last underwriting gain was recorded in 1987. The company’s composite ratio for the past 5 years has averaged about 112%, and the net loss ratio has averaged about 78%. The company would need a loss ratio of about 65% to show an underwriting profit, assuming that the expense ratio stays about the same.

The company did not annually compile data on loss ratio by agent, as recommended by the prior examination report, however after the end of exam fieldwork the company provided information on 5 years of property premiums and losses by agent, which examiners have summarized below:

AGENT	%of 5-years' Direct Property Premiums	Direct Property Loss ratio-5 years	
Agent 1	44.79%	81.80%	
Agent 2	5.87%	165.78%	
Agent 3	1.02%	24.96%	
Agent 4	0.57%	29.34%	
Agent 5	3.15%	204.43%	Agent 5 stopped writing in 1998
Agent 6	9.49%	50.19%	
Agent 7	35.11%	56.09%	
Total	100.00%	77.68%	

Agent 1 is the company's largest agent, and has a loss ratio that is significantly above the company's break-even loss ratio; agent 2 is a smaller volume agent but has a poor loss ratio; agent 5 stopped writing for the company several years ago. The other agents have loss ratios that are profitable for the company. This suggests that the company should focus re-underwriting and re-inspecting efforts on the blocks of business written by agents 1 and 2.

II. REINSURANCE

The examiners' review of the company's reinsurance portfolio revealed that there is currently one ceding treaty. The treaty reviewed contained a proper insolvency clause and complied with s. Ins 13.09 (3), Wis. Adm. Code, concerning maximum wind loss. Company retention of risk complied with s. Ins 13.06, Wis. Adm. Code.

Reinsurer:	Wisconsin Reinsurance Corporation
Effective Date:	January 1, 2002
Termination Provisions:	By either party giving 90 days' advance written notice, effective on contract anniversary date

The coverage provided under this treaty are summarized as follows:

1.	Type of contract:	Class A Excess of Loss
	Lines reinsured:	All business written by the company classified as Casualty.
	Company's retention:	$1,500 of each and every loss occurrence
	Coverage:	100% of each loss and loss adjusting expense occurring on the business covered by the exhibit, in excess of the company's retention, subject to maximum policy limits
	Premium:	75% of the net premium written, for each and every policy issued on business covered by this exhibit as of January 1, 2002
2.	Type of Contract:	Class B First Surplus
	Lines reinsured:	All property business written by the company
	Company's retention:	The company may cede on a pro rata basis up to $800,000 on a risk when the company's net retention is $300,000 or more. When the company's net retention is $300,000 or less in respect to a risk, the company may cede on a pro rata basis, and the reinsurer shall be obligated to accept up to 50% of such risk.
	Coverage:	Pro rata portion of each and every loss, including loss adjustment expenses, corresponding to the amount of the risk ceded
	Annual Aggregate Deductible:	The company shall retain an amount equal to 10% of the loss and loss adjustment expenses otherwise recoverable hereunder.
	Premium:	Pro rata portion of all premiums, fees and assessments charged by the company corresponding to the amount of risk ceded hereunder.
	Commission:	Provisional commission of 15% of premium ceded on pro rata reinsurance amounts over $300,000 per risk; on pro rata

reinsurance amounts less than $300,000 per risk a minimum commission of 15% shall be adjusted when the loss ratio is 65% or less. The minimum commission shall be increased by 1% for each 1% decrease in the loss ratio subject to a maximum commission of 35% when the loss ratio is 45% or less.

3. Type of Contract: Class B Combination Excess of Loss and Quota Share

Lines reinsured: All property business written by the company

Company's retention: A) Part I Excess Of Loss: Reinsurer shall indemnify 100% of any loss, including loss adjustment expense, in excess of $30,000 in respect to each and every risk, every loss occurrence. The company's retention is up to $70,000 in respect to each and every risk, each and every loss occurrence.

B) Part II Quota Share: Reinsurer shall be liable for 10% of each and every loss, including loss adjustment expenses. Reinsurer limit of liability under this part shall be $3,000 being 10% of $30,000 as respects to each loss occurrence.

Premium: A) Calculated by applying to the company's net written premium, the rate developed by taking the sum of the four year's losses incurred by the reinsurer, divided by the total of the net premiums written for the same period, multiplied by the factor of 100/80ths plus the quota share recovery rate. Minimum rate of 7%.

B) The Reinsurer shall be liable for 10% of each and every loss, including applicable loss adjustment expenses, on each business covered hereunder, which remains after recoveries, if any, under Part I – Excess of Loss. The Reinsurer's limit of liability shall be $3,000 being 10% of $30,000 as respects each loss each risk.

4. Type of Contract: Class C Excess of Loss Second Layer

Lines reinsured: All property business written by the company

Coverage and Limits: 100% of any loss, including loss adjustment expense, in excess of $100,000, limited to $200,000 in respect to each and every loss occurrence.

Premium: 2.20% of subject net premiums written with a minimum premium of $25,800 paid in equal monthly installments.

5. Type of Contract: Class D/E Stop Loss

Lines reinsured: All business written by the company

Coverage and limits: 100% of the company's aggregate net losses, including loss adjustment expenses, which exceed 70% of the company's net premiums written and subject to a minimum retention of $705,000.

Premium:	Calculated by taking the sum of the eight years' losses divided by the net premiums written multiplied by the factor of 100/80ths. Deposit premium of $88,500 payable in equal monthly installments Minimum rate: 7% of the current net written premiums Maximum rate: 25% of the current net written premiums

III. FINANCIAL DATA

The following financial statements were filed with the Commissioner of Insurance in the company's annual statement at December 31, 2001. Adjustments made as a result of the examination are noted at the end of this section in the area captioned "Reconciliation of Policyholders' Surplus."

Pella Mutual Insurance Company
Statement of Assets and Liabilities
As of December 31, 2001

Assets	Ledger	Nonledger	Not Admitted	Net Admitted
Cash in Company's Office	$ 200	$	$	$ 200
Cash Deposited in Checking Account	52,287			52,287
Cash Deposited at Interest	306,345			306,345
Bonds (at Amortized Cost)	807,139			807,139
Stocks or Mutual Fund Investments (at Market)	454,925			454,925
Real Estate (Net of Accumulated Depreciation and Encumbrances)	137,954			137,954
Premiums and Agents' Balances In Course of Collection	75,727		76	75,651
Premiums, Agents' Balances, and Installments Booked but Deferred and Not Yet Due	210,614			210,614
Investment Income Due or Accrued		15,354		15,354
Reinsurance Recoverable on Paid Losses and LAE	15,838			15,838
Electronic Data Processing Equipment – Excluding Software (Cost Less Accumulated Depreciation)	6,010			6,010
Other Assets:				
Reinsurance Commission Receivable	22,686			22,686
Due from broker	1,328			1,328
Due from agents – reimbursement	2,716			2,716
Furniture and Fixtures	7,307		7,307	
TOTALS	$2,101,076	$15,354	$7,383	$2,109,047

Liabilities and Surplus

Net Unpaid Losses	$ 116,775
Unpaid Loss Adjustment Expenses	1,500
Commissions Payable	61,224
Fire Department Dues Payable	131
Unearned Premiums	746,229
Reinsurance Payable	128,395
Amounts Withheld for the Account of Others	2,482
Payroll Taxes Payable	985
Other Liabilities:	
Expense Related	
Other Accrued Expenses	7,772
Nonexpense Related	
Premiums Received in Advance	16,875
TOTAL LIABILITIES	1,082,368
Policyholders' Surplus	1,026,679
TOTAL	$2,109,047

Pella Mutual Insurance Company
Statement of Operations
For the Year 2001

Net Premiums and Assessments Earned	$1,086,780
Deduct:	
Net Losses Incurred	843,672
Net Loss Adjustment Expenses Incurred	86,062
Other Underwriting Expenses Incurred	320,022
Total Losses and Expenses Incurred	1,249,756
Net Underwriting Gain (Loss)	(162,976)
Net Investment Income:	
Net Investment Income Earned	53,977
Net Realized Capital Gains	6,697
Total Investment Income	60,674
Other Income:	
Miscellaneous Income	214
Policy Fees	48,495
Late payment and re-write fees	1,178
Total Other Income	49,887
Net Income (Loss) Before Policyholder Dividends and Before Federal Income Taxes	(52,415)
Net Income (Loss)	$ (52,415)

Pella Mutual Insurance Company
Reconciliation and Analysis of Surplus as Regards Policyholders
For the Five-Year Period Ending December 31, 2001

The following schedule is a reconciliation of surplus as regards policyholders during the period under examination as reported by the company in its filed annual statements:

	1997	**1998**	**1999**	**2000**	**2001**
Surplus, beginning of year	$ 987,606	$1,011,007	$ 971,029	$ 978,861	$1,104,020
Net income	38,979	(81,271)	26,826	54,524	(52,415)
Net unrealized capital gains or (losses)	(20,605)	35,936	(22,099)	73,811	(26,437)
Change in non-admitted assets	5,027	5,357	3,105	(3,176)	1,511
Other gains and (losses) in surplus:					
Surplus, end of year	$1,011,007	$971,029	$978,861	$1,104,020	$1,026,679

Reconciliation of Policyholders' Surplus

A reconciliation of the policyholders' surplus as reported by the company in its filed annual statement and as determined by the examination is detailed in the following schedule:

Policyholders' Surplus per December 31, 2001, Annual Statement	$1,026,679

There were no changes or adjustments to Policyholder's Surplus

IV. SUMMARY OF EXAMINATION RESULTS

Compliance with Prior Examination Report Recommendations

Comments and recommendations contained in the last examination report and the action taken on them by the company are as follows:

1. Corporate Records—It is recommended that directors who are agents abstain from voting on issues that affect them directly.

   Action—Compliance

2. Corporate Records—It is recommended that the follow its established voting procedures for the election of officers.

   Action—Compliance

3. Articles and Bylaws—It is recommended that the company comply with s.13.03 (3) Wis. Adm. Code, as regards the company's address

   Action—Compliance

4. Underwriting—It is recommended that the company establish a plan to inspect all risks within the next three years

   Action—The company has partially complied.

5. Underwriting—It is recommended that the company consider ceasing to offer zero deductible policies, but in compliance with market conduct regulations on notice to policyholders.

   Action—Compliance

6. Underwriting—It is recommended that the company prepare reports by agent, and by line of business if deemed appropriate, that track loss frequency and severity of losses, and loss ratio, for such length of time as reliable information is reasonably available.

   Action—Non-compliance

7. Claims Adjusting - It is recommended that the company develop standards for renewals or rate increases based on loss experience, review claims experience of policyholders, and take appropriate actions.

   Action—Compliance

8. EDP-Environment—It is recommended that the company establish procedures to limit access to its computers.

   Action—Compliance

9. EDP Environment—It is recommended that the company establish a procedure in which its computer system is backed up off-site at least weekly.

   Action—Compliance

10. Disaster-Recovery Plan—It is recommended that the company develop a disaster recovery plan.

    Action—Compliance

11. Invested Assets—It is recommended that the company comply with s. 610.23, Wis. Stat., and s. Ins 13.05, Wis. Adm. Code, by executing a custodial or safekeeping agreement with bank or trust company which contains satisfactory safeguards and controls, including but not limited to

    (1) That the bank or trust company as custodian is obligated to indemnity the insurance company for any loss of securities of the insurance company in the bank or trust company's custody occasioned by the negligence or dishonesty of the bank or trust company's officers or employees, or burglary, robbery, holdup, theft, or mysterious disappearance, including loss by damage or destruction;

    (2) That in the event that there is a loss of the securities for which the bank or trust company is obligated to indemnify the insurance company, the securities shall be promptly replaced or the value of the securities and the value of any loss of rights or privileges resulting from said loss of securities shall be promptly replaced.

    Action—Compliance

Current Examination Results

Corporate Records

The minutes of the annual meetings of policyholders and meetings of the board of directors and any committees thereof, were reviewed for the period under examination and also for the subsequent current period.

Biographical data relating to company officers and directors have been reported in accordance with the provisions of s. Ins 6.52, Wis. Adm. Code.

The company does not have executed formal written agreements with its agents. The contracts do not include language indicating the agent will represent the company's interests "in good faith." It is recommended that the company execute formal written agreements with its agents. It was noted during the exam that several agents listed by the company had not been listed with this office's Agent Licensing section. It is recommended that the company maintain a current list of agent appointments with this office in a timely manner, pursuant to s. 628.11, Wis. Stat..

Conflict of Interest

In accordance with a directive of the Commissioner of Insurance, each company is required to establish a procedure for the disclosure to its board of directors of any material interest or affiliation on the part of its officers, directors, or key employees which conflicts or is likely to conflict with the official duties of such person. A part of this procedure is the annual completion of a conflict of interest questionnaire by the appropriate persons. The company has not adopted such a procedure for disclosing potential conflicts of interest. Conflict of interest questionnaires were reviewed for the period under examination with no apparent conflicts being disclosed. It was noted during the exam that a potential conflict of interest was not disclosed in the 2001 and 2002 conflict of interest statements. The company's manager has a financial interest in the company's largest agency, which is operated by the manager's relatives. It is recommended that the company ensure that officers, directors and key employees disclose all potential conflict of interest in accordance with s. 601.42, Wis. Stat.

Articles and Bylaws

The company's articles did contain the proper street address. The articles state the principal office for the transaction of business is located at Pella, Shawano County.

Fidelity Bond and Other Insurance

The company is afforded coverage under the terms of the following bonds or contracts and has complied with s. Ins 13.05 (6), Wis. Adm. Code, which sets forth the minimum requirements for fidelity bond coverage:

Type of Coverage	Coverage Limits
Fidelity	$250,000
Special Businessowners	$1,000,000 Business Liability
	242,000 Building Special
	59,000 Business Personal Property
	5,000 Medical Payments
	50,000 Fire Legal Liability
	14,000 Computer Coverage
Professional Liability	2,000,000 Insurance Company
	2,000,000 Directors and Officers
Worker's Compensation	Statutory
Error's and Omissions	1,000,000 Agent Liability

Underwriting

The company has a written underwriting guide. The guide covers all the lines of business that the company is presently writing.

The company has a formal inspection procedure for both new and renewal business. Under period of examination it was noted that the company completed re-underwriting and re-inspecting its 700 farm policies. The company has yet to implement its surveying and inspecting of the 4,000 plus primary homeowners and dwelling policies, and to identify those with woodburning stoves. The company also is looking into re-inspecting and re-underwriting commercial policies, as it is believed several businesses are undervalued and do not have enough coverage. It is recommended that the company establish a plan to inspect all its risks within the next three years. During the examination the examiner inquired with company management in obtaining a loss report by agent, and by line of business. Management did not have the loss ratio reports available for examiners, nor did the company compile the loss ratio information annually and present it to the Board of Directors annually. It is again recommended that the company prepare loss reports by agent, and by line of business if deemed appropriate, that track loss frequency and severity of losses, and loss ratios for such length of time as reliable information is reasonably available.

Claims Adjusting

The company has an adjusting committee consisting of at least three directors as required by s. 612.13 (4), Wis. Stat. The function of this committee is to adjust or supervise the adjustment of losses.

Accounts and Records

The examiners' review of the company's records indicated that the company is in compliance with s. Ins 13.05, Wis. Adm. Code, which sets forth the minimum standards for the handling of cash and recording of cash transactions by town mutual insurance companies. The examiners noted the following:

1. A proper policy register is maintained
2. A proper cash receipts journal is maintained
3. A proper cash disbursements journal is maintained
4. A proper general journal is maintained
5. A proper general ledger is maintained

An extensive review was made of income and disbursement items. Cash receipts were traced from source records and the proper recording and eventual deposit thereof ascertained. Negotiated checks issued during the period under examination were reviewed, test checked for proper endorsement, and traced to cash records. The verification of assets and determination of liabilities were made as of December 31, 2001.

The company is audited annually by an outside public accounting firm. The certified public accountants in planning and performing the audit of the financial statements of Pella Mutual Insurance Company noted the following internal control weakness. The main checking account was reconciled from the bank statement to the cash log; however, it was not reconciled to the general ledger. It is recommended that the company properly reconcile the balance appearing on the bank statement with the cash balance appearing on the company’s records at the end of each month in accordance with s. Ins 13.05 (4) (d), Wis. Adm. Code.

EDP Environment

Company personnel were interviewed with respect to the company's Electronic Data Processing environment. Access to the computer(s) is limited to people authorized to use the computer.

Company personnel back up the computers are done daily and the backed-up data is kept off-site.

A manual which describes how to use the company's software and outlines the steps to complete specific tasks assists in the continuity of operations for seldom-used applications, training, or when staff turnover occurs. The company has manuals documenting the use of its software.

Disaster Recovery Plan

A disaster recovery plan identifies steps to be performed in case the company loses a key employee, is not able to access its computer, information on its computer was lost, or the office building was destroyed, to name a few contingencies. The company has developed a disaster recovery plan.

Invested Assets

Section 610.23, Wis. Stat., requires insurers to hold all investments and deposits of its funds in its own name except that:

(1) Securities kept under a custodial agreement or trust arrangement with a bank or banking and trust company may be issued in the name of a nominee of the bank or banking and trust company; and

(2) Any insurer may acquire and hold securities in bearer form.

For securities not held under a custodial agreement or trust arrangement with a bank or banking and trust company, s. Ins 13.05 (4), Wis. Adm. Code, requires that:

> Non-negotiable evidences of company investments such as registered bonds, certificates of deposits, notes, etc., shall be maintained in a safe or vault with adequate safety controls or in a safety deposit box in a bank. Negotiable evidences of company investments shall be maintained in a safety deposit box in a bank. Access to a company safety deposit box containing negotiable securities shall require the presence and signature of at least 2 officers, directors or employees of the company.

The company is in compliance with these requirements.

Investment Rule Compliance

The investment rule for town mutuals allows a company to invest in common stocks, common stock mutual funds, and other higher risk investments (referred to as “Type 2”) provided that the town mutual has a sufficient amount of lower risk investments (referred to as “Type 1”). A town mutual may invest in Type 2 securities only if it already has sufficient Type 1 investments. Type 1 investments must equal or exceed the greater of items 1, 2, or 3.

1. Liabilities plus $300,000	$1,082,368
2. Liabilities plus 33% of gross premiums written	650,684
3. Liabilities plus 50% of net premiums written	527,992
4. Amount required (greater of 1, 2, or 3)	1,733,052
5. Amount of Type 1 investments as of 12/31/2001	1,306,250
6. Excess or (deficiency)	$ (426,802)

The company does not have sufficient Type 1 investments. The company’s total amounts of invested assets are below the required amount for Type 1 Investments. The company is limited to investing in Type 1 assets. Currently the company has one investment Type 2 investment (Shopko Store’s) bond, with a statement value of $40,196, which is in compliance with the new investment rule.

ASSETS

Cash and Invested Cash **$358,832**

The above asset is comprised of the following types of cash items:

Cash in company's office	$ 200
Cash deposited in banks-checking accounts	52,287
Cash deposited in banks at interest	306,345
Total	$358,832

Cash in the company's office at year-end represents the company's petty cash fund. A physical count was made by the examiners during the course of the examination and the balance reconciled to year-end.

Cash deposited in banks subject to the company's check and withdrawal consists of two accounts maintained in two banks. Verification of checking account balances was made by obtaining confirmations directly from the depository and reconciling the amounts shown thereon to company records.

Cash deposited in banks represents the aggregate of four deposits in four depositories. Deposits were verified by direct correspondence with the respective depositories and by an actual count and inspection of certificates and/or passbooks. Interest received during the year 2001 totaled $22,134 and was verified to company cash records. Rates of interest earned on cash deposits ranged from 2.47% to 5.10%. Accrued interest on cash deposits totaled $1,652 at year-end. It was noted during the examination that the company had not updated its signature card of authorized personnel on a money market account held with a local bank since February of 1998. It is recommended that the company update its current authorized signors on the company’s money market account.

Book Value of Bonds **$807,139**

The above asset consists of the aggregate book value of bonds held by the company as of December 31, 2001. Bonds owned by the company are held in a custodial account by a bank.

Bonds were not physically inspected by the examiners. The examiner received a copy of the company’s year-end custodial statement directly from the bank to confirm the investment as of December 31, 2001. Bond purchases and sales for the period under examination were checked to brokers' invoices and advice. The company's investment in bonds was in conformance with Wisconsin Statutes and the rules of the Commissioner of Insurance as regards investments made by town mutual insurers, except for one Shopko bond discussed earlier in this report.

Interest received during 2001 on bonds amounted to $46,076 and was traced to cash receipts records. Accrued interest of $13,702 at December 31, 2001, was checked and allowed as a non-ledger asset.

Stocks and Mutual Fund Investments $389,951

The above asset consists of the aggregate market value of stocks and mutual funds held by the company as of December 31, 2001. Stocks owned by the company are located in safe keeping at the bank in a trust account.

Stock certificates were physically examined by the examiners. Stock and mutual fund purchases and sales for the period under examination were checked to brokers' invoices and advice’s. The company's investment in stocks and mutual funds was in conformance with Wisconsin Statutes and the rules of the Commissioner of Insurance as regards investments made by town mutual insurers. It was noted during the examination that the company’s common stock investment in Wisconsin Reinsurance Corp. will be reduced in value by over $64,000 during 2002, based on WRC’s year-end 2001 audited financial statements. No adjustment was made, as this was a subsequent event to year ending December 31, 2001.

Dividends received during 2001 on stocks and mutual funds amounted to $11,735 and were traced to cash receipts records.

Book Value of Real Estate $137,954

The above amount represents the company's investment in real estate as of December 31, 2001. The company's real estate holdings consisted of the company’s home office and the land it is on.

The required documents supporting the validity of this investment were reviewed and were in order. Adequate hazard insurance was carried on the real estate and contents as noted under the caption, "Fidelity Bond and Other Insurance." The company's investment in real estate and related items was in conformance with the Wisconsin Statutes and the rules of the Commissioner of Insurance as regards investments made by town mutual insurers. Real estate depreciation is calculated using the straight-line method.

Agents' Balances or Uncollected Premiums **$75,651**

The above ledger asset represents the amounts due from agents or policyholders which are not in excess of 90 days past due at year-end. A review of individual agent's accounts verified the accuracy of this asset.

Premiums, Agents' Balances, and Installments Booked but Deferred and Not Yet Due **$210,614**

The above ledger balance represents the amounts due from agents or policyholders which are not in excess of 90 days past due at year end.

Investment Income Due and Accrued **$15,354**

Interest due and accrued on the various assets of the company at December 31, 2001, consists of the following:

Cash Deposited at Interest	$ 1,652
Bonds	$13,702

Reinsurance Recoverable on Paid Losses **$15,838**

The above asset represents recoveries due to the company from reinsurance on losses, which were paid on or prior to December 31, 2001. A review of year-end accountings with the reinsurer verified the above asset.

Electronic Data Processing Equipment **$6,010**

The asset represents the value of the computer equipment including the operating system software minus the depreciation, as of December 31, 2001. Operating software is not included in the admitted value.

Reinsurance Commissions Receivable **$22,686**

The above asset represents the amounts due company from reinsurer prior to December 31, 2001. This was verified to the year-end accounting data for the reinsurer.

Other Receivable **$4,044**

The other receivable asset listed above was verified to supportive documentation owed to company prior to December 31, 2001. Supporting records and subsequent cash receipts verified this item.

LIABILITIES AND SURPLUS

Net Unpaid Losses **$116,775**

This liability represents losses incurred on or prior to December 31, 2001, and remaining unpaid as of that date. The examiners' development of unpaid losses is compared with the amount estimated by the company in the following schedule. Differences are reflected in the section of this report captioned "Reconciliation of Policyholders' Surplus."

	Company Estimate	Examiners' Development	Difference
Incurred But Unpaid Losses	$444,394	$444,394	$0
Add:			
Incurred But Not Reported	10,000	10,000	0
Less:			
Reinsurance Recoverable on Unpaid Losses	337,619	337,619	0
Net Unpaid Losses	$116,775	$116,775	$0

The examiners developed this liability by totaling actual loss payments made through the development period on those losses incurred on or prior to December 31, 2001. To the actual paid loss figures was added an estimated amount for those 2001 and prior losses remaining unpaid at the examination date, if any. The examiner's development of the company's Incurred but unpaid losses showed adequacy. The company's actual Incurred But Not Reported is a best estimate that is derived from historical trends. The examiner's review of the Incurred But Not Reported showed it was understated. The examiner's verified claims paid in 2002 from the claims payment report to the company's case reserves as of December 31, 2001. However, the examiners noted that in reviewing claim payments made in 2002 for claims with incurred dates in 2001 and prior, that these claims exceeded the company's IBNR reserve by $4,700.89. The examiners deemed it unnecessary to reflect their findings in the above development as the difference was considered reasonable. However the company should consider tracking claims that have a date of loss in the year incurred, which are paid subsequent to the ending year of incurred loss, that are not found in the open case reserves of the year the loss was incurred. The company then should establish its IBNR for a given year by using an averaging method over a three-year period. It is recommended that the company should establish a more appropriate liability amount for Incurred But Not Reported amount. As a result of the examiners' development no adjustment was made to surplus.

The examiners' review of claim files included open claims, paid claims, claims closed without payment, and all claims which were denied during the examination period. The review indicated that claims are investigated and evaluated properly and that payments are made promptly and in accordance with policy provisions upon the submission of a proper proof of loss. In addition, the review of claims handling procedures and files revealed the following:

1. A proper loss register is maintained.
2. Claim files contained sufficient investigatory data and documentation to verify settlement payments or reserve estimates.
3. Proofs of loss were not properly signed.

The company determines on a discretionary basis if a claim warrants that a policyholder signs a proof of loss statement. Typically, the company requires a proof of loss statement with: theft and vandalism claims; salvage and subrogation claims; claims that may have a possible lawsuit filed against company; in the event there are coverage questions on the claim; or if there may be fraud involved. It is recommended that the company also establish a threshold on all claims over $5,000 by requiring a proof of loss to be completed by the insured.

Unpaid Loss Adjustment Expenses $1,500

This liability represents the company's estimate of amounts necessary to settle losses which were incurred prior to December 31, 2001, but which remained unpaid as of year-end. The methodology used by the company in establishing this liability is estimated mileage costs related to open claims and estimated incurred but not reported claims. The company would add to this additional amounts for estimated litigation or adjustment costs of any disputed claims had been referred to an outside adjuster or attorney.

The examiners' analysis of expenses incurred in the current year related to the settlement of prior year losses, as well as estimates of amounts necessary to settle any prior losses remaining unpaid at the examination date, determined this liability to be adequately stated.

Unearned Premiums **$746,229**

This liability represents the reserve established for unearned premiums in compliance with s. Ins 13.08 (3), Wis. Adm. Code. This reserve was established using a daily pro rata methodology.

Reinsurance Payable **$128,395**

This liability consists of amounts due to the company's reinsurer at December 31, 2001, relating to transactions that occurred on or prior to that date.

Excess	Quota Share	$43,974
	First Surplus	$42,045
	Class C-1, C-2	$42,376

Subsequent cash disbursements and reinsurance accountings verified the amount of this liability.

Fire Department Dues Payable **$131**

This liability represents the fire department dues payable at December 31, 2001.

The examiners reviewed the company's fire department dues calculation and found this liability to be correctly calculated. The actual amount paid was verified to the cash disbursement records.

Commissions Payable **$61,224**

This liability represents the commissions payable at December 31, 2001 The examiner recalculated individual commissions on a sample basis, and tied-out all detail of primary agents' commissions payable total as of year end, and confirmed payments of the primary agents' commission payable to a canceled check. The amounts were also verified to the detail listing of commissions payable.

Accounts Payable **$2,666**

This liability represents incurred amounts due vendors prior to December 31, 2001. The examiner verified subsequent year end payments.

Amounts Withheld for the Account of Others **$2,482**

This liability represents employee payroll deductions in the possession of the company at December 31, 2001. Supporting records and subsequent cash disbursements verified this item.

Payroll Taxes Payable **$985**

This liability represents the company's portion of payroll taxes incurred prior to December 31, 2001, which had not yet been paid. Supporting records and subsequent cash disbursements verified this item.

Accrued Expenses **$5,106**

This liability represents the salaries and wages payable incurred prior to year-end December 31, 2001. The examiner verified this through subsequent disbursement journal.

Premiums Received in Advance **$16,875**

This liability represents the amount of premiums received in 2001 for policy renewals due in 2002. The review of the policy register and premiums billings verified this amount. It was noted during the examination that the company is including its advance premiums as part of deferred installments. It is recommended that the company not report its advance premium as deferred installments, but rather include it as current billings.

V. CONCLUSION

Pella Mutual Insurance Company has reported admitted assets of $2,109,047, liabilities of $1,082,368, and surplus of $1,026,979. The company has reported net losses in 1998 and 2001 since last examination, and the company has reported underwriting losses in fourteen consecutive years.

In February of 2002, the company started a minimum deductible of $250 for new policies, and March 1st for renewals at the same $100 deductible rates. The company's current policies with a $250 deductible or higher will experience a rate increase ranging between 10% to 12%. As a result of these changes, the company anticipates that the estimated annual savings from higher deductibles should be between $75,000 to $100,000 in a normal loss year. The company anticipates that premium revenues will grow by $30,000 per year, as a result of the rate increases.

In addition to rate increases, the company continues to review individual loss history reports and determine if higher deductibles for renewal and non-renewal business are considered necessary. Finally, the company added a claim free discount to owner occupied mobile homes and farm owner policies.

The company's plans for 2003 are to begin reclassification of renewals to ISO fire department classifications. A new rate class for unprotected risks (over 6 miles from responding fire department) will be implemented. The company anticipates that the unprotected rate could be 15% to 20% higher than the current country rates. Other changes discussed by the company for 2003 and beyond are: 1) To add a claim surcharge -- different levels based on individual loss history. 2) Restrict roof coverage on outbuildings no longer used for farming purposes. 3) Restrict coverage for weight of ice/snow on buildings no longer used for farming purposes. 4) On replacement value policies, restrict roof coverage to ACV when roof is over 15 years old. 5) Restrict vandalism coverage on rental properties when vandalism is caused by tenants. 6) Analyze the underwriting of homes with completed basements where there is a potential for damage to sump pumps. 7) Add a woodburner surcharge – the company will need to determine which risks have woodburners. 8) Add additional agents in other parts of writing territory to continue to spread risk and continue to improve premium growth.

VI. SUMMARY OF COMMENTS AND RECOMMENDATIONS

1.	Page 17	Corporate Records—It is recommended that the company execute formal written agreements with its agents.
2.	Page 17	Corporate Records—It is recommended that the company maintain a current list of agent appointments with this office in a timely manner, pursuant to s. 628.11, Wis. Stat.
3.	Page 17	Conflict of Interest—It is recommended that the company ensure that officers, directors and key employees disclose all potential conflict of interest in accordance with s. 601.42, Wis. Stat.
4.	Page 18	Underwriting—It is recommended that the company establish a plan to inspect all risks within the next three years.
5.	Page 18	Underwriting—It is recommended that the company prepare reports by agent, and by line of business if deemed appropriate, that track loss frequency and severity of losses, and loss ratio, for such length of time as reliable information is reasonably available.
6.	Page 19	Accounts and Records—It is recommended that the company properly reconcile the balance appearing on the bank statement with the cash balance appearing on the company's records at the end of each month in accordance with s. Ins 13.05 (4) (d), Wis. Adm. Code.
7.	Page 23	Cash and Invested Cash—It is recommended that the company update its current authorized signors on the company's money market account.
8.	Page 26	Net Unpaid Losses—It is recommended that the company should establish a more appropriate liability amount for Incurred But Not Reported amount.
9.	Page 27	Net Unpaid Losses—It is recommended that the company also establish a threshold on all claims over $5,000 by requiring a proof of loss to be completed by the insured.
10.	Page 29	Premiums Received in Advance—It is recommended that the company not report premium billed in advance as deferred installments, but rather include it as current billings.

VII. ACKNOWLEDGMENT

The courteous cooperation extended to the examiners by the company's personnel is hereby acknowledged.

In addition to the undersigned, Amy Wolff of the Office of the Commissioner of Insurance, State of Wisconsin, participated in the examination:

Respectfully submitted,

DuWayne A Kottwitz
Examiner-in-Charge